

This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS PRAGUE 001846

SIPDIS

STATE FOR EUR/NCE, EB/IFD/OMA AND EUR/RPM
COMMERCE FOR 4232/ITA/MAC/MROGERS
TREASURY FOR OIA

E.O. 12958: N/A

TAGS: [ECON](#) [EFIN](#) [EZ](#) [GOV](#)

SUBJECT: CZECH PARLIAMENT PASSES 2005 STATE BUDGET

REF: PRAGUE 1426

1. By a 101-99 vote, the Czech Parliament approved on December 15 the 2005 state budget with a Kc 83.6 billion (\$3.7 billion) deficit -- essentially as presented to it by Prime Minister Stanislav Gross. (The state budget differs from the overall public budget in that it excludes certain off-budget funds and local government.) The budgeted deficit is less than 2003's expected Kc 114 billion actual state budget deficit. The government reportedly expects to take in Kc 71 billion (\$3.1 billion) more in taxes than in 2004, mainly due to increases in VAT receipts. VAT rates increased this year, and consumption is growing along with GDP. Without a determined approach to containing expenditures, however, the deficit is unlikely to change much.

2. Defense expenditures are slated to increase slightly from 2004 to Kc 52.9 billion (\$2.35 billion), about 1.8% of projected 2005 GDP. See refTel for a review of spending priorities in the budget.

3. The only serious issue at the end of the budget debate was what to do with savings from a delay in the scheduled pay increase for police and firemen. KDU-CSL leader Miroslav Kalousek -- who had fought the police pay increase and been the leading proponent of budget austerity -- wanted to steer more than half of the money into agricultural subsidies, benefiting a major KDU-CSL constituency. He failed to overcome the opposition of the CSSD members of parliament, supported by the Communists. At first the Communists wanted to pay for the increase by cutting the defense budget, and many CSSD deputies agreed with that idea. However, the small Freedom Union party (a coalition member) objected, and a compromise was worked out. Farmers will receive their payments from the off-budget agricultural fund. The savings from the police pay increase will be partly held in government reserves and partly spent on various current expenses, leaving the deficit as is. This outcome satisfied PM Gross, who was pleased that "no one will be able to go around the rural areas and claim they got them money" -- a barb aimed at Kalousek.

4. As expected, the budget debate presented only a manageable threat to survival of the CSSD-KDU-Freedom Union coalition. Next year's debate over the budget may be more contentious, and there is speculation that the KDU-CSL's Kalousek may foment differences with the CSSD to provide an excuse for leaving the coalition in advance of new elections.

In the meantime, the real challenge for the government is finding the political will to reform the pension and health systems in order to gain control of continuing high deficits and growing government debt. The debt is expected to reach 25% of GDP this year by GOCR calculations and even more if calculated in accordance with the European Union's ESA 95 standards.

CABANISS